

Internal Revenue Service

Number: **201637006**

Release Date: 9/9/2016

Index Number: 104.02-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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PLR-138960-15

Date: May 27, 2016

Legend

Taxpayer =

City =

Airport =

Port =

Charter =

Statute =

Plan A =

Plan B =

Plan C =

Supplemental Benefit A =

Supplemental Benefit B =

Dear _____ :

This is in reply to your private letter ruling request dated November 19, 2015 and subsequent correspondence concerning the tax treatment of certain disability and death payments made by Taxpayer under section 104(a)(1) of the Internal Revenue Code (the Code).

Taxpayer administers death, disability and retirement benefits that are paid to eligible individuals who are members of Plan A, Plan B, or Plan C (the Plans) and pursuant to the Charter and Statute. It is represented that the Plans are governmental pension plans. Each plan has received a favorable determination letter from the Internal Revenue Service. Membership in the Plans is limited to eligible employees and covered individuals who work for the City, Airport, or the Port. Membership in Plan A, Plan B, or Plan C is mandatory and a condition of employment for eligible employees and covered individuals. The Plans provide for different categories of members - for example, general member or executive member - based on an eligible employee's date of hire and job classification.

Industrial Disability

The Charter and Statute provide for a disability benefit to be paid to all eligible members who incur an industrial disability. For members hired after _____ and before _____, the general standard for whether an individual has incurred an industrial disability is the same for all the Plans. Generally, a member is treated as incurring an industrial disability if (1) the member is permanently incapacitated from the performance of duty, (2) the permanent incapacity is the result of injury or disease arising out of the course of employment, and (3) the permanent incapacity renders the member's retirement necessary. The determination of an individual's industrial disability is made by an independent agent of Taxpayer.

Members of the Plans who are hired after _____ will not be treated as incurring an industrial disability for any injury or incapacitation that is the result of a pre-existing medical condition or nervous or mental disorder.

In addition to the general standard for whether a member has incurred an industrial disability, certain members of Plan A who are employed by City as of _____, are treated as incurring an industrial disability if the member is a victim of a violent attack using deadly force that occurs in the performance of his or her duties, and that causes great bodily harm or a nervous or mental disorder.

A member who is determined to have incurred an industrial disability becomes entitled to an industrial disability retirement. Plan A members may elect to receive a maximum monthly benefit or a modified retirement allowance pursuant to §§ _____ through _____ of the Statute. As authorized by the Charter, Plan B and Plan C provide the

same maximum monthly benefit and options for a modified retirement allowance. Plan B, § and §§ through , and Plan C, § and §§ through .

When a retired member who is receiving an industrial disability benefit dies, § of the Statute provides that Plan A will provide a benefit equal to 50% of the member's monthly retirement allowance to the member's surviving spouse, so long as the surviving spouse was married to the member on the date of retirement and the surviving spouse does not qualify for and receive the industrial death benefit. Plan B and Plan C provide the same terms for the monthly retirement allowance paid to the member's surviving spouse or domestic partner. Plan B, § , and Plan C, § .

Section of the Statute provides that Plan A will provide industrial death benefits to survivors of a member who dies from industrial causes as determined by the Workers' Compensation Appeals Board. The industrial death benefit is either a lump sum payment, or the sum of a monthly allowance equal to one-half of the member's Final Compensation paid to the member's surviving spouse for life, plus a monthly annuity that is equal to the member's Accumulated Additional Contributions on the date the member died.

Plan B and Plan C similarly provide that the industrial death benefit is either a lump sum payment, or a monthly allowance equal to one-half of the member's "Final Average Salary", paid to the member's surviving spouse or domestic partner for life. Final Average Salary means the monthly average Base Compensation used to calculate the amount provided to each member upon retirement based on a specific formula. Plan B, § and Plan C, § .

Industrial Disability Retirement Allowance - Plan A

Under §§ and of the Statute, a Plan A member who has been determined to have incurred an industrial disability shall be entitled to receive an industrial disability retirement allowance paid in equal monthly installments. The industrial disability retirement allowance shall equal 50% of the member's "Final Compensation" plus an annuity purchased with Accumulated Additional Contributions, if any. In the case of a Plan A member who is eligible for a service retirement, the industrial disability retirement allowance shall be the greater of the member's industrial retirement allowance, or the service retirement allowance reduced by an annuity purchased with Accumulated Additional Contributions. Under Plan A, a member's Final Compensation means the member's highest one-year period of "Base Compensation" for the relevant period, the average of the member's three highest years of "Base Compensation" for the relevant period, or the average of a member's three highest years of "Base Compensation" for the relevant period.

Section _____ of the Statute defines “Accumulated Additional Contributions” to mean the sum of a member’s post-tax contributions and interest. Section _____ provides that any workers compensation amount that may be awarded to a member shall be offset against any industrial disability retirement pension payments, and the offset does not apply to the annuity of any industrial disability retirement allowance awarded.

Industrial Disability Retirement Allowance – Plan B

Under Plan B, § _____, a Plan B member who has been determined to have incurred an industrial disability shall be entitled to receive an industrial disability retirement allowance paid in equal monthly installments. The industrial disability retirement allowance shall equal to 33 1/3 % of the member’s “Final Compensation” plus an annuity that is the actuarial equivalent of the member’s “Accumulated Cost of Living Annuity Contributions” and, if applicable, an annuity based on the Plan B member’s “Accumulated Surviving Spouse” or “Domestic Partner Contributions” credited to the member’s account at retirement. In the case of a Plan B member who is eligible for a service retirement and the member’s service retirement allowance would be greater than the member’s industrial disability retirement allowance, the member will receive: (1) a disability retirement allowance equal to 33 1/3% of the member’s Final Compensation paid in monthly installments plus (2) an additional allowance equal to the difference between the industrial disability retirement allowance and the service retirement allowance the member has earned. An industrial disability retirement allowance is derived from an annuity based on that member’s “Accumulated Normal Contributions,” plus an annuity which is the actuarial equivalent of the Plan B member’s Accumulated Cost of Living Annuity Contributions, and if applicable, an annuity based on the member’s Accumulated Surviving Spouse or Domestic Partner Contributions credited to the member’s account at retirement, and a disability retirement pension derived from contributions of the Airport.

Plan B, § _____ defines “Accumulated Cost of Living Annuity Contributions” to mean all cost of living contributions credited to a Plan B member’s account and interest. Under Plan B, a member’s Final Compensation means the member’s highest one-year period of “Base Compensation” for the relevant period, or the member’s highest three-year period “Base Compensation” earned for the 3 consecutive months preceding his or her retirement for the relevant period.

Industrial Disability Retirement Allowance – Plan C

Under Plan C, § _____, certain Plan C members who are determined to have incurred an industrial disability shall be entitled to receive an industrial disability retirement allowance paid in equal monthly installments. The industrial disability retirement allowance shall equal 50% of the member’s “Final Compensation.” In the case of a Plan C member who is eligible for a service retirement and the member’s service retirement allowance would be greater than the member’s industrial disability retirement,

the member will receive (1) a disability retirement allowance equal to 50% of the member's Final Compensation paid in monthly installments, plus (2) an additional allowance equal to the difference between the industrial disability retirement allowance and the service retirement allowance the member has earned. For other Plan C members, the provisions are the same except that the industrial disability retirement allowance is equal to 33 1/3% of Final Compensation. Plan C, § and . Plan C, § further provides that the industrial disability retirement allowance is derived from an annuity based on a member's "Accumulated Normal Contributions" and a disability retirement pension derived from contributions of the Port.

Plan C, § defines "Accumulated Normal Contributions" to mean the sum of all normal contributions credited to a Plan C member's account plus and interest. Under Plan C, a member's Final Compensation means the member's highest one-year period "Base Compensation" for the relevant period, or the member's highest three-year period Base Compensation for the relevant period.

Cost of Living Adjustments and Supplemental Benefits – Plan A

Section of the Statute provides for general cost of living adjustments (general COLAs) to the Plan A industrial disability retirement allowances under §§ , of the Statute, the industrial disability survivor allowances under §§ through of the Statute, and the industrial death benefits under § of the Statute. The retirement allowance payable to members (or their survivors) who retired prior to are also increased for a supplemental cost of living adjustment (supplemental COLA). A member's benefit that includes the supplemental COLA is the benefit that is further adjusted by the general COLA.

Plan A members who have started to receive Plan A benefits may be paid an additional supplemental benefit based on a special formula. According to § of the Statute, the additional supplement benefit, if any, shall include Supplemental Benefit A. Section of the Statute provides that the additional supplemental benefit, if any, that is paid shall include a specified annual increase of the member's benefit determined without regard to any other supplement or additional benefits.

Cost of Living Adjustments and Supplemental Benefits – Plan B

Plan B members who have started to receive Plan B benefits may be paid an additional supplemental benefit based on a special formula. The additional supplemental benefit, if any shall include Supplemental Benefit B. Supplemental Benefit B allows a covered member to choose, at the time of the member's retirement, to have the member's basic service retirement allowance calculated based on certain alternatives that can increase the service retirement allowance for purposes of Plan B.

Plan B, § provides for general COLAs to the Plan B industrial disability allowances under §§ , the industrial disability survivor allowances under §§ through , and the industrial death benefits under § . Plan B has a limit on the COLA adjustment to a maximum of 2% in any one year pursuant to Plan B, § .

Cost of Living Adjustments and Supplemental Benefits – Plan C

Plan C members who have started to receive Plan C benefits may be paid an additional supplemental benefit based on a special formula. The additional supplemental benefit, if any, shall include Supplemental Benefit B. Supplemental Benefit B allows a covered member to choose, at the time of the member's retirement, to have the member's basic service retirement allowance calculated based on certain alternatives that can increase the service retirement allowance for purposes of Plan C.

Plan C, § provides for general COLAs to the Plan C industrial disability allowances under § , § § , and the industrial disability survivor allowances under §§ through , and the industrial death benefits under § , as well as a Supplemental COLA Annuity for Plan C. Plan C has a limit on the COLA adjustment to a maximum of 2% in any one year pursuant to § .

RULINGS REQUESTED

(1) Industrial disability retirement allowances paid under Plan A, Plan B, and Plan C to members who incur a disability through the performance of duty will not be considered gross income to the recipient under section 104(a)(1) of the Code to the extent such benefits are not based on the member's age, length of service, or prior contributions.

(2) Survivor benefits paid under Plan A, Plan B and Plan C to a survivor of an industrial disability retirement retiree will not be considered gross income to the recipient under section 104(a)(1) of the Code to the extent such benefits are not based on the member's age, length of service, or prior contributions.

(3) Industrial death benefits paid under Plan A, Plan B, and Plan C to survivors of members who die as a result of the performance of duty will not be considered gross income to the recipient under section 104(a)(1) of the Code.

(4) COLA benefits, supplemental COLA benefits, and Supplemental Benefit A allowances paid to a member who is receiving industrial disability allowances under Plan A, or a survivor of a member receiving industrial survivor or death benefits under Plan A, will not be considered gross income to the recipient under section 104(a)(1) of the Code. COLA benefits, supplemental COLA benefits, and Supplemental Benefit B allowances paid to a member who is receiving industrial disability allowances under Plan B or Plan C, or a survivor of a member receiving industrial survivor or death

benefits under Plan B or Plan C, will not be considered gross income to the recipient under section 104(a)(1) of the Code.

(5) Industrial disability retirement allowances paid under a domestic relations order (DRO) (as applicable to government plans) will not be considered gross income to the recipient under the DRO to the same extent that the underlying industrial disability retirement allowance is not considered gross income to the member.

Section 61(a)(1) provides that, except as otherwise provided, gross income includes all income from whatever source derived, including compensation for services.

Section 72(a) of the Code provides that, except as otherwise provided by law, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment or life insurance contract.

Section 104(a)(1) of the Code provides that gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

Section 1.104-1(b) of the Income Tax Regulations states that section 104(a)(1) of the Code excludes from gross income amounts received by an employee under a workmen's compensation act or under a statute in the nature of a workmen's compensation act that provides compensation to the employee for personal injury or sickness incurred in the course of employment. However, section 104(a)(1) does not apply to a retirement pension or annuity to the extent that it is determined by reference to the employee's age or length of service, or the employee's prior contributions, even though the employee's retirement is occasioned by an occupational injury or sickness. Section 1.104-1(b) of the regulations also states that section 104(a)(1) applies to compensation which is paid under a workmen's compensation act to the survivor or survivors of a deceased employee.

In Revenue Ruling 80-44, 1980-C.B. 34, a statute in the nature of a workmen's compensation act provided for an allowance of the greater of (A) 60 percent of the individual's average final compensation, or (B) the amount to which the individual would be entitled under the normal, years of service, retirement plan. The ruling concluded that the benefits under the statute were excludable under section 104(a)(1) of the Code to the extent that they did not exceed 60 percent of the final average compensation. Any excess over 60 percent of final average compensation was attributable to length of service, and therefore, not excludable from gross income. Rev Rul. 80-44 also holds that benefits of the surviving spouse which are a continuation of the employee's benefits are excludable under section 104(a)(1) of the Code in the same percentage as the employee's benefits were excludable.

Rev. Rul. 80-84, 1980-1 C.B. 35, considered section 183 of a Los Angeles, California statute that provided benefits to survivors when “any member of the Fire or Police Department shall die ... after retirement, or while eligible for retirement from such department on account of years of service ...”. The ruling concluded that benefits paid to employees’ survivors may qualify as paid under a statute in the nature of a workmen’s compensation act where those benefits are a mere continuation of employees’ section 104(a)(1) benefits.

In Rev. Rul. 85-104, 1985-2 C.B. 52, the Service considered a statute under which the participants who were disabled due to work-related injury or sickness, receive the greater of a fixed percentage of base salary or an amount computed on the basis of years of service. The Service concluded that an amount up to the percentage of base salary specified by the statute would be excludible from the participant’s gross incomes under section 104(a)(1) of the Code but that any excess, computed on the basis of length of service, would not be excludible under section 104(a)(1).

Section 104(a)(1) is strictly construed to conform to the general purview of section 61 that all income is taxable unless explicitly excluded. The industrial disability retirement benefits are specifically paid to City employees for their work-related injury or sickness, and not the work-related injury or sickness of the former spouses. Moreover, section 1.104-1 of the regulations explicitly limits the exclusion from income to employees and their survivors. Similarly, no such exclusion is available for domestic partners. Neither the Code nor the regulations provide an exclusion from income for amounts paid to former spouses pursuant to a domestic relations order. See Fernandez v. Commissioner, 138 T.C. 378 (2012).

Benefits paid under the Statute for industrial disability benefits are paid only for work-related disabilities and those benefits are paid without regard to an employee’s age or length of service, and are thus in the nature of a workmen’s compensation act.

Based on the representations made and authorities cited above, we conclude as follows:

(1) Industrial disability benefits paid under §§ and of the Statute will not be gross income to the Plan A recipient to the extent the benefits do not exceed 50% of the member’s Final Compensation. Industrial disability benefits paid pursuant to , will not be gross income to the Plan B recipient to the extent that the benefits do not exceed 33 1/3% of the member’s Final Compensation. Industrial disability benefits paid pursuant to Plan C, § , will not be gross income to the Plan C recipient to the extent that benefits do not exceed 50% of the member’s Final Compensation. The portion of the benefit that exceeds that amount not included in gross income, in each of the three Plans, will be gross income to the recipient under section 72 of the Code.

(2) Industrial disability benefits paid to a survivor of a member pursuant to §§ [redacted] through [redacted] of the Statute by Plan A, Plan B, §§ [redacted], and [redacted] - [redacted], and Plan C, §§ [redacted], and [redacted] - [redacted], to a survivor of a member determined to have an industrial disability will not be gross income to the recipient to the same extent the allowance was payable to the member.

(3) Industrial death benefits paid under §§ [redacted] of the Statute by Plan A, Plan B, § [redacted], and Plan C, § [redacted], to survivors of members who die as a result of the performance of duty will not be considered gross income to the recipient under section 104(a)(1) of the Code.

(4) COLA benefits paid under §§ [redacted] and [redacted], and Supplemental COLA Benefit A paid under §§ [redacted] of the Statute to (i) a Plan A member who is determined to have an industrial disability, or (ii) a survivor of a Plan A member under subsection (i) receiving benefits under §§ [redacted] - [redacted], or industrial death benefits under § [redacted], will not be considered gross income to the recipient to the same extent as the industrial disability allowance or survivor benefit is not considered gross income to the recipient. COLA benefits paid under Plan B, § [redacted], and COLA benefits paid under Plan C, §§ [redacted] and [redacted], including the Supplemental COLA Benefit B, will also not be considered gross income to the recipient to the same extent as the industrial disability allowance or survivor benefit is not considered gross income to the recipient.

(5) Industrial disability retirement allowances paid under a DRO will be considered gross income to the recipient under the DRO.

No opinion is expressed as to the federal tax consequences of payments not expressly covered in the requested rulings or the transaction under any other section of the Code or Statute other than those specifically stated above.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

R. Lisa Mojiri-Azad
Assistant Branch Chief, Health & Welfare Branch
Office of Associate Chief Counsel
(Tax Exempt and Government Entities)